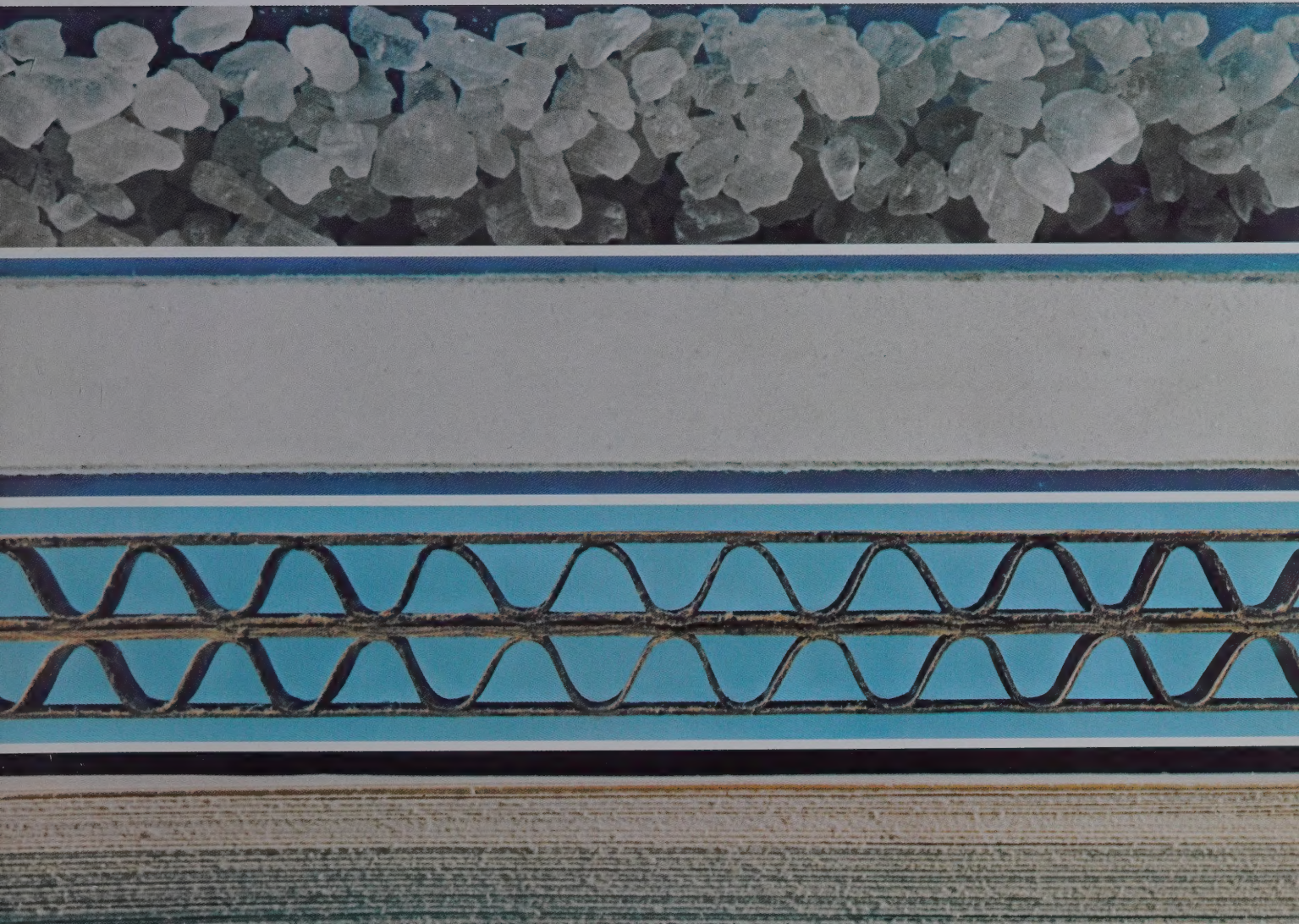


AR43

Domtar Inc. 1978 Annual Report

Our
Fiftieth
Annual
Report
1929-1978



Domtar Inc. 1979
Legal Deposit 1st quarter
1979
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Les actionnaires qui préféreraient recevoir leurs rapports
en français voudront bien en aviser le Secrétaire de
Domtar Inc.

The Cover

Domtar Chemicals Group

Domtar Construction Materials

Domtar Packaging

Domtar Pulp & Paper Products

Domtar Inc.
1978 Annual Report

Highlights

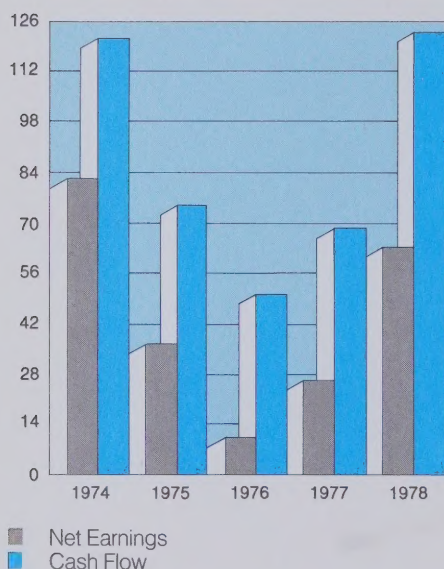
	1978	1977
For the year		
In millions —		
Sales	\$ 1,241	\$ 1,010
Employees' salaries, wages and benefits	\$ 337	\$ 297
Net earnings	\$ 63	\$ 27
Cash flow from operations	\$ 123	\$ 68
Capital investments	\$ 74	\$ 51
Increase (decrease) in cash and short term investments less bank indebtedness	\$ 8	\$ (14)
Per common share —		
Earnings	\$ 4.23	\$ 1.78
Dividends	\$ 1.10	\$ 0.80
Cash flow from operations	\$ 8.26	\$ 4.56

At year end

In millions —		
Working capital	\$ 259	\$ 237
Funded debt — long term	\$ 175	\$ 174
Shareholders' equity	\$ 394	\$ 348
Debt/equity ratio	31:69	33:67
Shareholders —		
Number of preference shareholders ...	1,486	1,537
Number of common shareholders	20,393	22,244
Common shares outstanding	14,827,300	14,827,300
Equity per common share	\$ 25.78	\$ 22.65
Employees —		
Number of employees	17,414	16,815

Report of the Directors to the Shareholders

Net Earnings and Cash Flow
(millions of dollars)

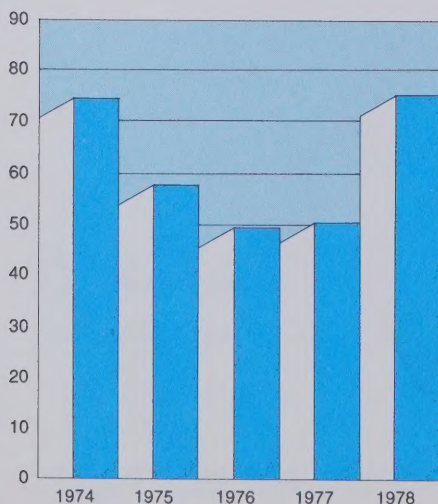


Profit Increase

Earnings reached \$4.23 per common share in 1978 versus \$1.78 per share in 1977. Major reasons for the substantial improvement were:

- The lower valued Canadian dollar increased sales realization on Domtar's exports, encouraged export volume and discouraged imports.
- Production efficiencies and volume improved as a result of employee efforts and capital investments.
 - The Cornwall Fine Papers mill increased the capacity of its largest paper machine by 30% and solved start-up problems on the rebuilt coated board machine.
 - Newsprint mills operated at full capacity, broke daily production records and reduced costs through thermomechanical pulping and by operating improvements to the Murdock-Domtar sawmill and wood processing complex which became wholly owned at the end of 1977.
 - The Construction Materials particleboard mill at Huntsville, Ontario, reduced start-up problems.
 - The Packaging group improved productivity through investment in equipment.
 - The Sifto Salt and Lime divisions increased capacities.
- Two gypsum wallboard plants and a related paper mill acquired in California and a gypsum mine (49% owned) in Mexico have proven highly successful.
- Stronger Canadian demand increased sales of corrugated containers, insulation materials and pulp and papers.
- Penetration into United States markets resulted in increased volume for gypsum and other Canadian construction material products.
- Labour settlements were achieved with a minimum of work disruptions and at rate increases which generally reflected the need for the Corporation's facilities to improve their cost competitive position with United States producers.

Capital Investments
(millions of dollars)



Cash Flow and Financial Position

- Cash flow was \$ 123 million. 1978 was the first year since 1974 in which the cash flow generated was adequate for the long term health of the Corporation.
- Cash and short term investments, net of bank indebtedness, were \$ 81 million at December 31, 1978.
- The \$ 81 million was after expenditures of:
 - \$41 million on fixed assets.
 - \$35 million on acquisitions.
 - \$13 million for the corporate reorganization which included the redemption of bonds and preferred shares earlier than their maturity dates.

Dividends Increased

- Quarterly dividends on the common shares were increased progressively throughout the year from an annualized rate of \$0.80 to \$1.80 per share, as follows:

Declared	Payable	Amount Per Share
January 26, 1978	May 1, 1978	\$0.20
April 27, 1978	August 1, 1978	0.20
September 6, 1978	November 1, 1978	0.25
November 10, 1978	February 1, 1979	0.25
December 27, 1978	February 1, 1979	0.20
Applicable to 1978		<u>\$1.10</u>

In addition, on December 27 a further dividend of \$ 0.45 per common share was declared, payable on May 1, 1979 and is applicable to the three months ending April 30, 1979.

- Quarterly dividends of \$0.25 on the preferred shares — \$1.00 applicable to 1978 — were declared as in previous years. In addition, on December 27, 1978, a further \$0.25 dividend was declared applicable to the first quarter of 1979.

Capitalization Changes

- Approximately \$ 49 million was transferred from retained earnings to the common share stated capital account, resulting in a deemed dividend from the 1971 capital surplus on hand being available to any shareholder in a position to use it.

Corporate Reorganization

- To achieve internal efficiencies, most of Domtar's Canadian subsidiaries were amalgamated into Domtar Inc. Three subsidiaries — Buntin Reid Paper Co. Limited, Hinde and Dauch Limited and St. Lawrence Corporation Limited — had minority shareholders. Their common and preferred shares and the outstanding debentures of St. Lawrence Corporation Limited were acquired at a cost of some \$ 13 million.

Offers Withdrawn

- On December 21, Domtar, reacting to the knowledge of a forthcoming bid from MacMillan Bloedel Limited, announced its intention to acquire all of the outstanding common shares of the latter on a share exchange basis. On December 22, MacMillan Bloedel announced that it had acquired approximately 19% of Domtar's common shares and intended to acquire, on a pro-rata basis, a sufficient number of shares to bring its ownership of Domtar to 51%. On December 29, Domtar and MacMillan Bloedel jointly declared that each had agreed to withdraw their respective offers. Domtar's decision was prompted by the intervention of the Premier of British Columbia who indicated that he would take steps to block Domtar's offer.
- Shortly before this event, Domtar's long and productive association with Argus Corporation Limited was severed. For the past 30 years, Argus Corporation, through the vision, leadership and counsel of its directors and officers, has made a priceless contribution to the structure, organization, dynamism and results achieved by Domtar.

Accounting Change

- As a result of a new bulletin issued by the Canadian Institute of Chartered Accountants, the treatment of unrealized foreign exchange gains and losses has been changed. Its principal effect is to revalue the Corporation's long term debt of \$50 million in United States funds at the rate prevailing on December 31, 1978 rather than at that on the date when the debt was issued. As a result, \$ 9 million of the potential loss remains to be written off over the 18 year balance of the repayment term. For more details, please refer to the financial statement notes.

Employee Relations

- The Corporation conducted a record number of negotiations in 1978, including renewal of the collective agreements for most of the primary mills in the Pulp & Paper group. There were 70 settlements, leaving 33 negotiations to be concluded in 1979.
- Despite the heavy schedule of negotiations, the time lost by work disruptions was minimal in 1978 with the Corporation experiencing nine strikes ranging from one shift to nine weeks in duration.
- Although the trend was to higher wage settlements, employees and their bargaining representatives in the pulp and paper sector recognized the need to improve cost competitiveness with the pulp and paper industry in the United States. As a result, the cost of settlements in this sector increased by approximately 7% in the first year of the agreements and by 6% in the second. Agreements in the Construction Materials and Chemicals groups were settled at higher levels in recognition of competing rates and labour market conditions.
- During 1978, rationalization of production facilities resulted in the displacement of 72 unionized employees at two locations. In one instance, the work force was absorbed by an adjacent Domtar operation. In the other, the Domtar Industrial Conversion Plan was available to help the affected employees. Administered by a joint labour-management committee and financed by Domtar, the plan is designed to assist in relocation to other employment and to supplement existing government programs.
- Continuing emphasis is being directed throughout the Corporation to improve performance in the field of occupational health and safety.
- In compliance with Quebec's French Language Charter, the Corporation obtained in 1978 a provisional certificate of francization and completed the linguistic analysis of all its locations in Quebec. Special regulations by the Office de la Langue Française permitting the use in Head Offices of a language other than French were issued but these still require increased use of French. A comprehensive francization program is also mandatory and is being developed.

Central Research

- Two new devices were licensed for manufacture and sale: the Domtar Chip Thickness Classifier and the Domtar Disintegrator to release the latent properties of mechanical pulp.
- The Corporation is re-evaluating its research activities with the aim of directing more emphasis to projects which will benefit its long term fortunes.

Public Affairs

- In response to the program proposed by the Quebec government to give new impetus to the province's pulp and paper industry, the Corporation submitted recommendations relating to energy conservation, transportation, effluent control and forest management. Particular emphasis was placed on financing arrangements and on the recognition by the government of present and future supply and demand forces within the market place.
- Donations in support of health and welfare, education, scholarships, community and cultural activities undertaken by registered Canadian charitable organizations totalled \$258,000 in 1978. In addition, Domtar employees at all operating locations continued to work voluntarily for a variety of community activities ranging from fund raising drives for United Appeals to local improvement projects. To support parliamentary democracy, the Corporation also contributed \$ 28,000 to Canadian political parties.

Outlook for 1979

- More cash will probably be spent in 1979 than in 1978 to modernize and expand facilities and acquire new businesses.
- Specific major projects scheduled for completion in 1979 include a gypsum wallboard plant in Caledonia, Ontario and a fire retardant ceiling panel plant in Cornwall, Ontario.
- Downside risks include the impact of a possible recession in the United States, the inflation voluntary restraint program in that country, a higher valued Canadian dollar, extra competitive capacity in domestic markets, a further housing construction decline and inflation in Canada squeezing profit margins.
- Upside possibilities include a further improvement in the efficiencies achieved in 1978, a lower valued Canadian dollar and a better demand-supply balance in several product lines.

Long Term Goals

- In pursuit of the long term goals outlined in the 1977 Annual Report, the Corporation purchased gypsum assets in California and Mexico and introduced the portfolio management approach to strategic planning.
- Domtar's strategic planning evaluates each plant or mill as a business unit which must justify its own needs or opportunities for capital in relation to its probable long term profitability and risks.
- To upgrade Domtar's product mix, investment is being channelled to Canadian and United States businesses which are:
 - cost competitive in their markets.
 - generally unaffected by factors beyond the Corporation's control such as foreign exchange, tariffs and energy costs.
 - growing at least with the general economy.
 - enjoying customer acceptance and a prime market position.

Board of Directors

Your Directors were profoundly saddened by the death on March 15, 1978 of Mr. John A. McDougald, Chairman and President of Argus Corporation Limited and a Director of Domtar since April 3, 1951. In his passing, Canada has lost a distinguished leader of outstanding human qualities and business stature. His guidance and counsel in the affairs of the Corporation will be greatly missed. The Directors extend their deepest sympathy to the bereaved family.

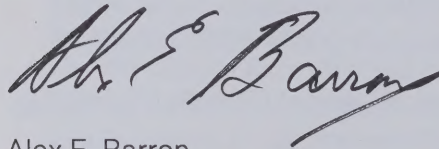
Mr. Lorne C. Webster of Montreal, President of Prenor Group Ltd., was elected to the Board of Directors in April to fill the vacancy created by the death of Mr. McDougald.

In December 1978, Messrs. A.L. Fairley Jr. and A. Bruce Matthews, C.B.E., D.S.O. asked to retire as Directors. Their resignations were regretfully accepted by the Board.

Appreciation

The Directors wish to express their sincere appreciation to all Domtar employees whose efforts, skill and dedication made possible the Corporation's earnings achievement in 1978 and placed it in a position to improve on this outstanding performance in 1979.

On Behalf of the Board



Alex E. Barron
Chairman of the Board



Alex D. Hamilton
President and Chief Executive Officer

Reports on Operations

REPORT ON OPERATIONS

Domtar Pulp & Paper Products

Overall Group

- Operating profit in 1978 was \$ 40 million on sales of \$ 565 million. This is an increase of 23% over the 1977 sales total and is a significant step towards a satisfactory profit level. Here are the factors which contributed:
 - The decline in the exchange rate of the Canadian dollar against the United States dollar helped profits in three ways: Exports sold in U.S. funds realized more Canadian dollars; volume increased as our Canadian mills became more cost competitive in export markets; and United States mills became less cost competitive in Canadian markets.
 - The North American economy recovered from its 1975-76 recession. Lengthy strikes in some United States mills also affected North American supply. Hence, capacity utilization, a key factor in price change and profitability, increased and in many cases reached the maximum practical level. As capacity utilization peaked, prices firmed and then moved upward.
- 1978 saw a greater awareness by a number of provincial and federal government agencies of the pulp and paper industry's need to modernize and improve its cost competitive position. Much of the eastern Canadian industry operates at a cost disadvantage in comparison with major producers in the United States. To combat this problem, government began to develop plans and incentive programs to assist industry modernization. Although these programs are still embryonic, it is encouraging to see a growing recognition of the importance of a healthy and competitive industry to the well-being of Canada and Canadians.
- Labour settlements during 1978 were generally negotiated in a climate of reason in contrast with the turmoil experienced during the 1975-1976 negotiations.

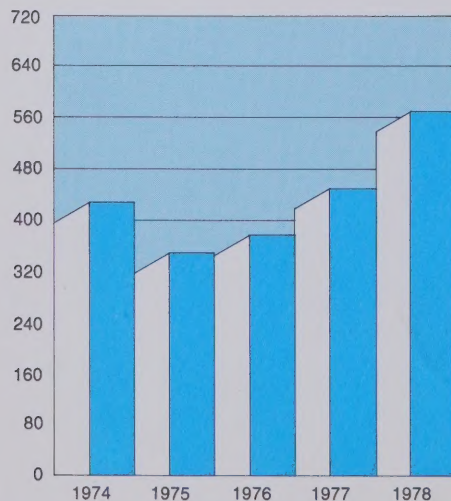
Domtar Fine Papers

- Fine Papers entered 1978 from a strong demand base and improved throughout the year. As part of a major program to achieve cost competitiveness, equipment changes were made to the Cornwall mill's largest paper machine, No. 7, to increase its capacity by 30%. In 1977, product and process problems had developed following a rebuild of Cornwall's No. 1 paper machine to produce machine coated board grades. The problems were solved by mid-1978. This unit is now a significant contributor to the performance of Canada's biggest fine paper mill.

Domtar Newsprint

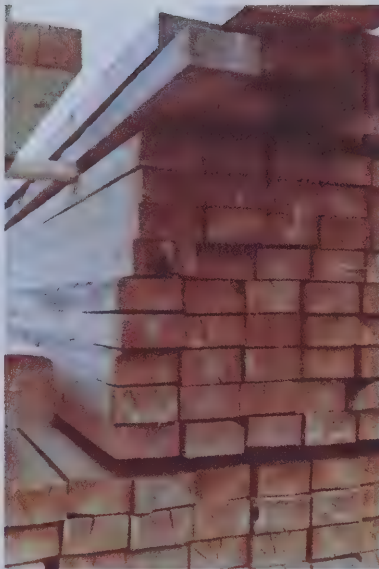
- The Newsprint division experienced a satisfactory year in its markets and mills as well as from an earnings standpoint. The manufacturing facilities, in contrast with 1977, operated free of strikes and at full capacity. Consumption of newsprint and groundwood specialty grades were at record levels in Canada and the United States.

Pulp & Paper Products Sales
(millions of dollars)





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1. Kraft operator Wayne Duhaime prepares to charge 540-pound bales of kraft pulp, produced at the Lebel-sur-Quévillon mill of Domtar Pulp, into the kraft pulper at the Cornwall Fine Papers mill.

2. Two-by-four studs are just one of the lumber products produced at the four mills of Domtar Forest Products. Demand for lumber was strong during most of 1978.

3. Paperback book text pages are printed on Domtar groundwood specialty paper produced at the Donnacona mill of Domtar Newsprint.

4. Plainfield® Offset 297(M) paper manufactured at the Cornwall mill of Domtar Fine Papers is inspected before being fed into a modern, four-colour, sheet-fed, offset press at a Montreal printer.

Domtar Pulp

- The pulp market in early 1978 was seriously depressed by slack demand, under-utilized capacity, high inventories and severe price erosion. As 1978 progressed, demand strengthened and world inventories have now declined to below normal customer service levels. Operating rates improved sharply in late 1978 and prices firmed, setting the stage for the recovery to former price levels. As such, the Pulp division expects significantly improved earnings in 1979. The chlor-alkali plant servicing the Lebel-sur-Quévillon, Quebec pulp mill was not cost competitive and did not warrant further investment. It was shut down in May 1978 and the work force absorbed. The refuse boiler installed in 1977 at Lebel-sur-Quévillon has been a very successful investment and has made a major contribution to the mill's energy and cost reduction programs. Unfortunately, the mill continues to be plagued with occasional operating disruptions but some major investments in 1979 are expected to correct them. Personnel turnover at Quévillon remains as a nagging problem requiring continuing management attention.

Domtar Forest Products

- The Forest Products division's lumber business operated in a strong market during 1978 with prices some 25% above 1977 levels. With the purchase of the interest of Murdock Lumber Limited in Murdock-Domtar Inc., the Pulp & Paper group now operates four sawmills with a total annual capacity of 215 million board feet. In 1979, Domtar will for the first time market its lumber production through its own sales force.
- With nearly all markets for the products of the Pulp & Paper group at full demand levels, the overall supply of fibre to the mills in the form of chips and roundwood has tightened. Due to the strong wood purchase position which Domtar has developed over the years combined with the harvest from its forest reserves, no supply problems are anticipated in 1979.

Dominion Envelope Company Limited

- Dominion Envelope Company Limited, a subsidiary, enjoyed another profitable year and continues to be an important force in its selected markets.



Domtar Pulp & Paper Products

1 Domtar Forest Products

kiln dried spruce and pine dimension lumber and studs.

Woodland operations: Red Rock, Ontario; Cornwall, Ontario; Lebel-sur-Quévillon, Quebec; Dolbeau, Quebec.

Sawmills: Sapawe, Ontario; Girardville, Quebec; Mistassini, Quebec.

Studmill: Lebel-sur-Quévillon, Quebec.

2 Domtar Newsprint

standard newsprint and groundwood specialty and coated publication grade papers.

Mills: Donnacona, Quebec, Dolbeau, Quebec.

3 Domtar Pulp

bleached and unbleached softwood and hardwood sulphate pulp; semi-bleached softwood sulphate pulp; and unbleached sulphite pulp.

Mill: Lebel-sur-Quévillon, Quebec.

4 Domtar Fine Papers

uncoated and coated fine papers for the printing, business and converter trades as well as specialty papers such as diazo base, glassine, grease-proof and carbonizing.

Mills: St. Catharines, Ontario; Don Valley, Ontario; Cornwall, Ontario; Beauharnois, Quebec; Windsor, Quebec; Sunderland, England.

Fine papers are sold domestically through sales offices and a national network of six Domtar fine papers merchants (including Canada's largest, Buntin Reid Paper). As the largest Canadian exporter of fine papers, Domtar Fine Papers sells through sales representatives to 60 countries. There are sales offices in Stamford, Connecticut; Jamaica; Australia and Britain.

5 Dominion Envelope Company Limited

envelopes and specialty bags.

Plant: Toronto, Ontario.

REPORT ON OPERATIONS

Domtar Packaging

Overall Group

- Generally brisk demand in all product areas during all but the first quarter of 1978 resulted in a 7.7% increase in sales to \$ 210 million from the 1977 level of \$ 195 million. Operating profit totalled \$ 21 million in 1978.
- Manufacturing operations at all 16 plants and mill locations were more profitable in 1978. Minimal time was lost due to strikes. Labour relations were generally excellent. The continuing upward trend of labour and material costs was partially offset by increased production volume, cost savings resulting from the capital investment programs of previous years and price increases.
- The sale of the Converted Papers division in October 1977, due to its continued unsatisfactory financial performance, also favourably affected 1978 results.

Corrugated Containers Division

- Corrugated container sales and profits continued to grow throughout all markets served at rates in excess of the Canadian economy as a whole. Domtar supplies about 22% of the Canadian markets for these products. The division is in the process of establishing a corrugated sheet plant in Vancouver to increase its participation in the burgeoning British Columbia market which the division has hitherto served by shipments from its Calgary operation.

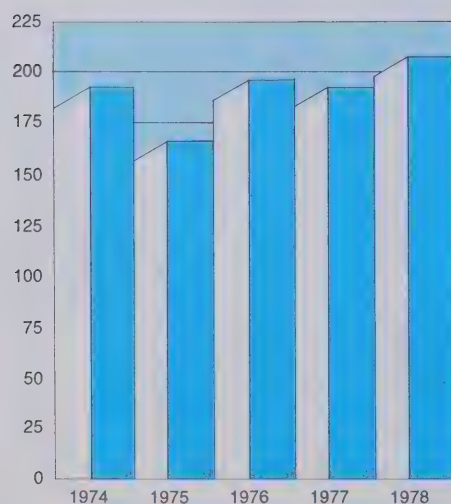
Composite Can Division

- Profits generated by the Composite Can division improved slightly over 1977. This business is characterized by fast moving changes in both products and product design.

Eastern Coated Papers Limited

- Results achieved by Eastern Coated Papers Limited, a subsidiary, were about the same as 1977. Despite extremely competitive markets for its tape product lines during most of the year, business improved toward year-end and the prospects for 1979 are encouraging. The subsidiary has acquired important technology in electrostatic reprographics from Mead Corporation in the United States. This new business area is well suited to Eastern Coated Papers and its solvent coater installations and expertise.

Packaging Sales
(millions of dollars)

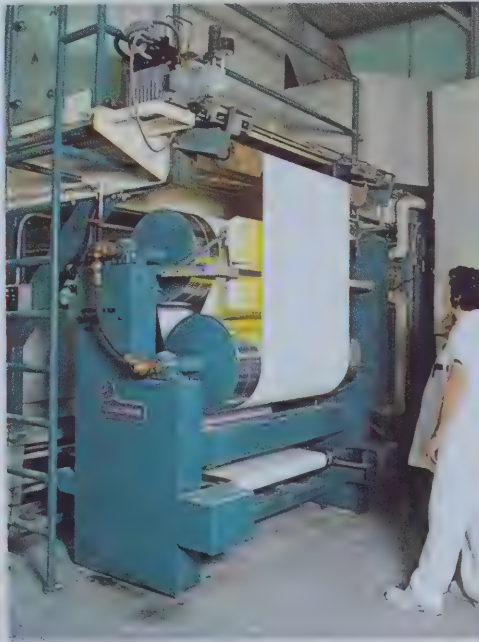




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1. Corrugator is in operation at the Leaside, Ontario plant of the Corrugated Containers division where productivity and individual performance are among the highest in North America. The division is Canada's largest manufacturer of corrugated shipping containers.
2. Palletizer unit at the Chatham, Ontario plant of the Composite Can division automatically stacks 2,016 lubricating oil containers — 14 layers of 144 cans — on a pallet ready for loading onto freight car or truck.
3. Electrostatic coated paper used in photocopying machines is produced at the Dorval, Quebec plant of Eastern Coated Papers Limited, a Domtar subsidiary. Operator George Melanson inspects the coating.

Kraft Paper and Board Division

- All basic manufacturing facilities for paper and paperboard operated at full capacity throughout the second half of the year. The kraft paper machines at the East Angus, Quebec mill operated at capacity for most of the year. By permitting smoother and more economical manufacturing operations than experienced from 1975 to 1977, operating conditions in 1978 contributed significantly to increased profits.

The East Angus mill performed well during the year. The new working arrangements reached with its unionized employees in late 1977 resulted in markedly reduced costs, increased production and enhanced profits. The cooperative and interested participation of all employees fosters the hope that a valuable long term role may be developed for the East Angus facility despite its age and certain inherent cost disadvantages.

The continuation of reasonable growth in the Canadian economy in 1979 is expected to increase sales and operating profits of the Packaging group.



Domtar Packaging

1 Kraft Paper and Board division

linerboard, corrugated medium, kraft papers and boxboards for package manufacture.

Mills: Red Rock, Ontario; Trenton, Ontario; East Angus, Quebec.

2 Corrugated Containers division

corrugated shipping containers and displays.

Plants: Calgary, Alberta; Winnipeg, Manitoba; Etobicoke, Ontario; Kitchener, Ontario; Leaside, Ontario; Peterborough, Ontario; St. Mary's, Ontario; Montreal, Quebec; Quebec City; Moncton, New Brunswick.

3 Composite Can division

small fibre containers for fruit juices, dough, motor oil and other consumer products.

Plants: Chatham, Ontario; Prescott, Ontario.

4 Eastern Coated Papers Limited

plain and reinforced gummed tapes, photocopy paper and coated papers for wrappings.

Plant: Dorval, Quebec.

Domtar Construction Materials

Overall Group

- Earnings were at record levels and were due more to the new Domtar Gypsum America operation in California and the increased marketing of products from our Canadian plants in the buoyant United States market than to increased demand in Canada. Operating profit at \$ 26 million on sales of \$ 281 million was almost 50% greater than the record previously set in 1975.
- Significant developments in the group's business in 1978 included:
 - Acquisition of the gypsum assets of Kaiser Cement & Gypsum Corporation in California and Mexico.
 - Start of construction of the new gypsum wallboard plant at Caledonia, Ontario.
 - Installation of equipment for manufacturing fire rated ceiling panels at Cornwall, Ontario.
 - Opening a fully serviced sales office in the Cleveland, Ohio area.

Domtar Gypsum America Inc.

- In April 1978, Domtar purchased the fully integrated gypsum wallboard complex of Kaiser Cement & Gypsum Corporation, consisting of two gypsum wallboard plants, a wallboard paper mill, all in California, a gypsum mine (49% owned) in Mexico and two ore-carrying vessels.
- The effective manner in which the management of that business achieved the transition in ownership was particularly encouraging.
- Despite full capacity operations, the two Californian wallboard plants and the associated paper mill were unable to meet demand. Although this operation has California as its primary market, it is also cost competitive in adjacent states and holds a significant share of the Hawaiian market.

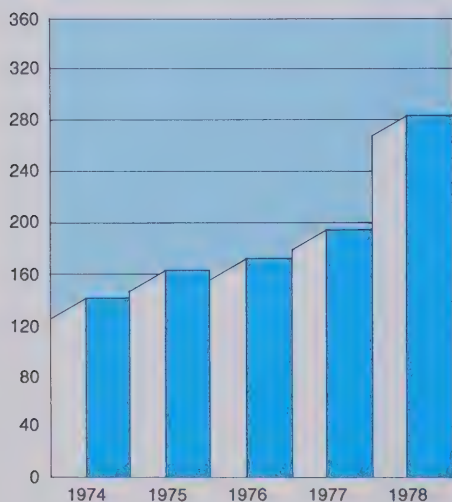
Domtar Construction Materials Canadian Market

- Canadian market demand did not meet expectations. The reduced pace of housing starts at 223,000 units were below forecast and approximately 10% below the 1977 level. The inventory of newly completed and unsold units carried into the beginning of the year, combined with general economic conditions, limited price increases to below the overall rate of inflation. Other building construction activity remained at the level of the past three years. However, there was a wide variance in activity across the country with Alberta being particularly strong. In some major product lines, price increases did not keep pace with increased costs.

Roofing Products

- Roofing Products experienced a difficult year with profit margins declining to their lowest level in recent years as competitors vied to increase or maintain their market shares. All roofing manufacturing operations were converted to metric sizes by mid year with additional productive capacity being achieved at the same time.

Construction Materials Sales
(millions of dollars)





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1. One of two ore vessels owned and operated by a Domtar company, the "Mar de Cortez" berthed beside the Long Beach, California gypsum board plant, unloads gypsum rock from the Domtar gypsum mine at San Marcos Island, Mexico.
2. Arborite® decorative laminates are used in a variety of design and architectural settings in the home and in industry.
3. Scheduled to enter production in 1979, the new gypsum board plant in Caledonia, Ontario, a quarter of a mile in length, is the most modern of its kind in North America.
4. Dramatic roofing shingle design complements the brick work of this attractive modern home.
5. Production line at the Domtar Gypsum America gypsum board plant in Long Beach, California.
6. Bricks manufactured at the Ottawa brick plant of Domtar Construction Materials feature in this high rise apartment building under construction in the capital.

Gypsum Products

- The gypsum plants in Western Canada ran at full capacity to meet a vigorous demand. Nevertheless, inventory shortages were experienced and customers experienced delays in deliveries. The demand for wallboard in the Eastern Canadian markets declined. However, this was more than offset by strong demand in the northeastern United States prompted by the devalued Canadian dollar. High levels of activity resulted in improved profit margins for gypsum products.

Insulation Products

- Sales of Fiberglas(*) building insulation were at a record level as a result of higher building standards, the upgrading of older buildings for energy conservation and the increased availability of material from suppliers.

Masonry Products

- Profits of Masonry Products reflected the reduction in housing activity in Eastern Canada and slower results than anticipated from cost reduction programs.

Arborite® Products

- Significant improvements occurred in the performance of the particleboard and Cladboard® decorative laminate plant in Huntsville, Ontario, where productivity in recent months has attained rated capacity. Over the year, however, cash flow was still negative.
- Improved results were also recorded for Arborite® decorative and industrial laminates primarily as a result of rationalizing manufacturing facilities and product lines. The process has unfortunately resulted in layoffs but affected employees are covered by the Domtar Industrial Conversion Plan.

® Registered trade mark of Domtar Inc.

(*) Registered trade mark.



Domtar Construction Materials

1 Arborite® Products

ARBORITE® decorative and industrial plastic laminates; particleboard; and CLADBOARD® decorative laminates.

Particleboard; Cladboard® decorative panels: Huntsville, Ontario.

High pressure decorative and industrial laminates: Vaughan, Ontario; LaSalle, Quebec.

2 Masonry Products

clay brick and HAYDITE® lightweight aggregate.

Plants: Mississauga, Ontario; Ottawa, Ontario; LaPrairie, Quebec.

3 Gypsum Products

GYPROC® gypsum wallboard, lath, wall panelling, plasters and associated products.

Plants: Surrey, B.C.; Calgary, Alberta; Winnipeg, Manitoba; Caledonia, Ontario; Montreal, Quebec; Windsor, N.S.

Gypsum mines: Gypsumville, Manitoba; Caledonia, Ontario.

4 Domtar Gypsum America Inc.

gypsum wallboard.

Plants: Antioch, California, Long Beach, California.

Paper mill: San Leandro, California.

Gypsum mine (49% interest): San Marcos Island, Mexico.

5 Roofing Products

asphalt shingles, roll roofing and siding.

Plants: Burnaby, B.C.; Lloydminster, Alberta; Brantford, Ontario; Thorold, Ontario; Lachine, Quebec.

6 Insulation Products

roof sheathing, panel board, ceiling tiles, grid panels, non-combustible grid panels; national distributor of FIBERGLAS® building insulation.

Plants: Fire-rated ceiling panels: Cornwall, Ontario.

Roofing and ceiling products; ceiling tile: Donnacona, Quebec.

7 Specialty Products

plastic conduit, wall and ceiling system components.

Plants: Wall and ceiling system components: Scarborough, Ontario.

Plastic conduit: St-Laurent, Quebec.

Domtar Chemicals Group

Overall Group

- Sales by the Chemicals group totalled \$ 194 million, or 14% over those in 1977, and operating profit kept pace with this increase. A total of 19 labour agreements were negotiated, of which the majority were for more than one year. Labour-management relations were generally good throughout 1978.

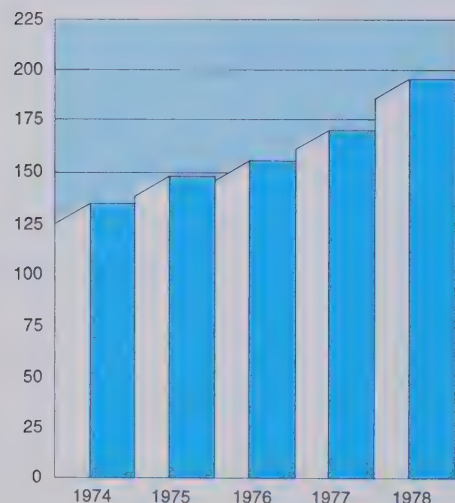
CDC Division

- In the fourth quarter of 1978, the Tar & Chemical division was merged with the CDC division (formerly Chemical Developments of Canada Limited) to form a larger and more viable group. Operating as the CDC division, the new organization will be more cost effective and endowed with a stronger management team.
- As separate units, the Tar & Chemical and the CDC divisions both achieved excellent results in 1978 due to the high capacity operations of the two major plants at Hamilton and Longford Mills, Ontario.
- During the year, the LaSalle, Quebec tar products plant was shut down and the property sold. A new specialty tar products plant was added to the existing Hamilton facility and came into production in November. Representing a threefold increase in capacity, the new facility is expected to satisfy the growing demands of the specialty tar products market over the next few years.
- The CDC division increased its market share for dyestuffs and specialty chemicals for household and industrial end uses. Although 1979 sales are forecast to increase by 14%, growing competitive pressures are expected to limit gains in operating profit. The division will increase its research and product development activities.

Lime Division

- Supported by a strong demand for lime by the United States steel industry, the level of sales and operating profit of the Lime division increased. Sales to Canadian base metal and pulp and paper producers also improved but construction industry markets for stone and lime products remained weak. A new rotary kiln was installed and put into operation to double the productive capacity of the Joliette, Quebec plant, which supplies quicklime to Quebec and New England markets. Despite the uncertain recovery of United States steel production in the face of low cost imports and the threat of an economic slowdown, increased penetration of markets served by the Joliette plant should further improve earnings in 1979.

Chemicals Sales
(millions of dollars)





1.



2.



3.



4.



5.

1. Premier René Lévesque of Quebec, second from left, was the guest of honour at inaugural ceremonies for the new rotary kiln at the Joliette lime plant. With him, from left, are plant manager Pierre Poulin, Domtar president Alex D. Hamilton and divisional production manager Gaston Brousseau.

2. Console of the pollution abatement unit at the Longford Mills plant of the CDC Division enables special technician Wayne Johnston to monitor and control the purification of the contaminated portion of the plant's effluent.

3. Adzing, boring and incising mill at the Delson Wood Preserving plant enables operator Maurice Sabourin to prepare more than 4,000 railway ties for treatment each eight-hour shift.

4. The specialty products facility at the Hamilton tar plant was announced, built and placed in operation, on budget, in 1978. The products manufactured there include driveway sealer, tar based roofing cements and a range of products for distribution by Domtar Construction Materials.

5. Sifto® table salt products are as familiar to householders as they are to restaurant and institutional users.

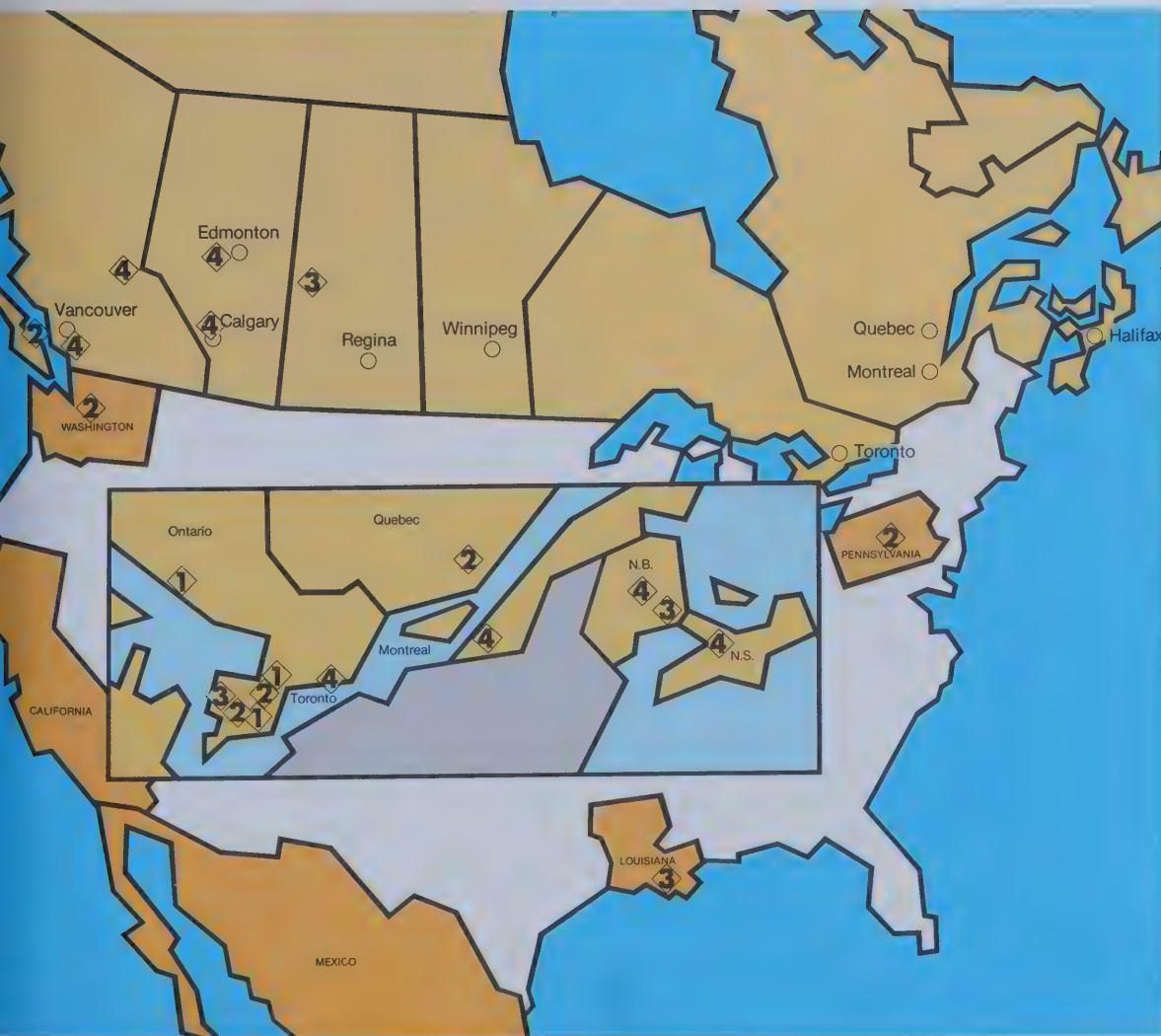
Sifto Salt Division

- Earnings of this division were at a record level in 1978. Sifto® Salt operations in the United States were particularly encouraging, as a substantial carryover of inventories from the previous year permitted record highway sales and the reduced value of the Canadian dollar relative to the United States dollar benefitted results in that country.
- In keeping with its policy of strengthening and improving its distribution services, the division acquired facilities for bulk handling and bagging rock salt in the Milwaukee area. Projections for next year are optimistic, with every indication of improved results from the Cote Blanche, Louisiana mine and of operating rates at the evaporator plants increasing over 1978. However, sales of rock salt in the northern United States are expected to return to normal levels, resulting in somewhat lower profits for the division in 1979.

Wood Preserving Division

- Railway market demand was normal but that of the commercial sector was below normal. Largely due to product price rigidity, it was not possible to offset rising costs by increasing prices with the result that some erosion of profit margins occurred. The tie mill at the Delson, Quebec plant was replaced. Northwest Wood Preservers Ltd. at Dawson Creek, British Columbia was sold. New approaches to safety at work initiated in 1977 resulted in a 50% reduction in the frequency rate for lost-time accidents in 1978. Business volume in 1979 is expected to increase by 5%, but with continuing erosion of profit margins.

® Registered trade mark of Domtar Inc.



Domtar Chemicals Group

① CDC division

synthetic detergents; wetting agents; carboxy-methylcellulose; dyestuffs and pigments; coal tar pitches and acids; creosote; naphthalene; and phthalic anhydride.
Plants: Synthetic detergents: Longford Mills, Ontario.

Coal tar products and by-products: Sault Ste Marie, Ontario; Hamilton, Ontario.

② Lime division

limestone, hydrated lime and quick-lime for the steel, paper and glass industries.

Quarries and/or plants: Tacoma, Washington; Blubber Bay, B.C.; Beachville, Ontario; Hespeler, Ontario; Joliette, Quebec; Bellefonte, Pennsylvania.

③ Sifto Salt division

SIFTO® products — ice control, chemical, industrial and table salt.

Evaporator salt plants: Unity, Saskatchewan; Goderich, Ontario; Amherst, N.S.

Rock salt mines: Goderich, Ontario; Cote Blanche, Louisiana.

Distribution centres: Strategically located in major ports on the St. Lawrence River, the Great Lakes and the Ohio and Mississippi Rivers.

④ Wood Preserving division

pressure treated wood products for utility, railway, construction and agricultural use.

Treatment plants: New Westminster, B.C.; Prince George, B.C.; Cochrane, Alberta; Edmonton, Alberta; Trenton, Ontario; Delson, Quebec; Newcastle, N.B.; Truro, N.S.

DOMTAR INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
 DECEMBER 31
 (Thousands of dollars)

ASSETS

	1978	1977
Current assets:		
Cash and short-term investments, at cost (approximates market value)	\$100,854	\$ 85,139
Receivables	176,721	150,950
Inventories	154,181	143,344
Prepaid expenses	<u>5,312</u>	<u>3,432</u>
	\$437,068	\$382,865
Investments and advances	7,762	11,702
Fixed assets:		
Plant, machinery and facilities	858,658	811,653
Timber limits and land	<u>32,879</u>	<u>31,386</u>
	891,537	843,039
Less: Accumulated depreciation	<u>488,741</u>	<u>457,197</u>
	402,796	385,842
Intangible assets and deferred charges:		
Unamortized balance of unrealized exchange losses	8,596	—
Unamortized debt discount and expenses	1,143	1,246
Goodwill and other intangibles	<u>6,082</u>	<u>865</u>
	15,821	2,111
	<u>\$863,447</u>	<u>\$782,520</u>

APPROVED BY THE BOARD:

A.E. Barron, Director

A.D. Hamilton, Director

LIABILITIES AND SHAREHOLDERS' EQUITY

	1978	1977
Current liabilities:		
Bank indebtedness.....	\$ 19,887	\$ 12,192
Payables	134,861	113,136
Income and other taxes payable.....	16,298	8,617
Dividends payable.....	6,800	3,182
Funded debt due within one year	<u>—</u>	<u>8,882</u>
	\$177,846	\$146,009
Funded debt.....	175,006	173,939
Deferred income taxes	113,051	103,493
Minority interest	3,209	11,225
Shareholders' equity:		
Stated capital —		
\$1 cumulative redeemable preference shares without nominal or par value, redeemable at \$25 per share		
Authorized and outstanding —		
512,916 shares	12,054	12,054
14,827,300 common shares	181,674	132,744
Retained earnings	<u>200,607</u>	<u>203,056</u>
	394,335	347,854
	<u>\$863,447</u>	<u>\$782,520</u>

See accompanying summary of accounting policies and notes to financial statements

DOMTAR INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

YEAR ENDED DECEMBER 31

(Thousands of dollars)

Revenue:

	1978	1977
Sales.....	\$1,240,909	\$1,009,508
Investment and sundry income	<u>13,991</u>	<u>8,956</u>
	\$1,254,900	\$1,018,464

Expenses:

Cost of sales and selling and administrative expenses	1,088,429	920,838
Depreciation.....	43,629	38,907
Loss on disposal of fixed assets	<u>2,294</u>	<u>—</u>
	1,134,352	959,745

Earnings before interest, income taxes and minority interest

Interest – funded debt	15,661	16,022
– other indebtedness.....	<u>1,334</u>	<u>864</u>
	16,995	16,886

Earnings before income taxes and minority interest

Income taxes – current	28,130	12,770
– deferred	<u>11,420</u>	<u>950</u>
	39,550	13,720

Earnings before minority interest

Minority interest.....	64,003	28,113
	<u>699</u>	<u>1,273</u>

Net earnings

	\$ 63,304	\$ 26,840
Earnings per common share	<u>\$ 4.23</u>	<u>\$1.78</u>

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED DECEMBER 31

(Thousands of dollars)

	1978	1977
Balance at beginning of year	\$203,056	\$188,591
Retained earnings capitalized	<u>48,930</u>	<u>—</u>
	154,126	188,591
Net earnings	<u>63,304</u>	<u>26,840</u>
	217,430	215,431
Dividends:		
Preference shares, \$1.00 per share....	\$ 513	\$ 513
Common shares, \$1.10 per share (1977 – 80¢)	<u>16,310</u>	<u>11,862</u>
	16,823	12,375
Balance at end of year	<u>\$200,607</u>	<u>\$203,056</u>

See accompanying summary of accounting policies and notes to financial statements

DOMTAR INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED DECEMBER 31

(Thousands of dollars)

	1978	1977
Funds provided by:		
Net earnings	\$ 63,304	\$ 26,840
Items not affecting cash flow from operations —		
Depreciation	43,629	38,907
Loss on disposal of fixed assets ..	2,294	—
Deferred income taxes	11,420	950
Minority interest	699	1,273
Other	1,699	199
Cash flow from operations	123,045	68,169
Investments and advances	4,742	142
Disposal of fixed assets	3,499	4,636
	\$131,286	\$72,947
Funds used for:		
Fixed asset purchases	41,039	37,989
Businesses acquired, less \$1,373 working capital at acquisition	33,420	12,695
Reduction of funded debt	8,923	16,560
Minority interest purchased	8,715	3,913
Par value of preference shares purchased	—	523
Dividends	16,823	12,375
	108,920	84,055
Increase (decrease) in working capital	22,366	(11,108)
Increase in non-cash working capital	14,346	2,876
Increase (decrease) in cash and short- term investments less bank indebtedness	\$ 8,020	\$(13,984)
Changes in components of non-cash working capital:		
Receivables	\$ 25,771	\$ 20,003
Inventories	10,837	(2,548)
Prepaid expenses	1,880	(81)
Payables	(21,725)	(1,935)
	16,763	15,439
Income and other taxes payable	(7,681)	(4,204)
Dividends payable	(3,618)	11
Funded debt due within one year	8,882	(8,370)
Increase in non-cash working capital	\$ 14,346	\$ 2,876

See accompanying summary of accounting policies and notes to financial statements

DOMTAR INC. AND SUBSIDIARIES
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
DECEMBER 31, 1978

The Corporation follows the generally accepted accounting principles described below. These, together with the notes which follow, should be considered an integral part of the consolidated financial statements.

Principles of consolidation:

The accompanying financial statements include the accounts of Domtar Inc. and all its subsidiaries.

Translation of foreign currencies:

Amounts stated in foreign currencies are translated into Canadian dollars as follows: asset and liability accounts at year-end rates, except inventories, investments, fixed assets, intangible assets and deferred income taxes which are translated at rates prevailing at the transaction dates; revenue and expenses (other than those relating to assets and liabilities translated at historical rates) at average rates for the year.

Gains and losses arising from translation are included in net earnings, except for the gains and losses relating to the translation of long-term receivables and payables which are deferred and amortized over the remaining lives of the related assets and liabilities.

Valuation of inventories:

Inventories of pulpwood, raw materials and operating and maintenance supplies are valued at the lower of cost and replacement cost. Finished goods, including work in process, are valued at the lower of cost and net realizable value.

Fixed assets and depreciation:

Fixed assets are recorded at cost. The cost and related accumulated depreciation of items retired or disposed of are removed from the books and any gains or losses are included in the consolidated statement of earnings.

Depreciation is provided on the straight-line method using rates based on the estimated useful lives of the assets which are generally as follows:

Production machinery	12 – 16 years
Logging Equipment	Up to 6 years
Automobiles	4 years
Buildings	Up to 40 years

Expenditures for repairs and maintenance are charged against earnings as incurred.

Income taxes:

The Corporation provides for income taxes on the tax allocation basis. The provision for deferred income taxes mainly arises as a result of depreciation being claimed for income tax purposes in excess of amounts of depreciation recorded for financial statement purposes. The Corporation follows the flow-through method of accounting for the federal investment tax credit.

Intangible assets and deferred charges:

Unrealized exchange losses are amortized over the remaining lives of the related debt.

Discount and expenses on the issue of funded debt are amortized on a straight-line basis over the terms of the related obligations.

Goodwill represents the excess of the cost of shares of acquired companies over the values attributed to the underlying net assets. The Corporation follows the policy of amortizing goodwill on a straight-line basis over periods not exceeding twenty-five years.

Other intangibles are amortized on a straight-line basis over their estimated useful lives.

DOMTAR INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1978

1. Inventories:

	1978	1977
	(Thousands of dollars)	
Logs and pulp chips	\$ 17,135	\$ 15,211
Raw materials and operating and maintenance supplies	67,881	60,253
Finished goods including work in process	69,165	67,880
	<u>\$154,181</u>	<u>\$143,344</u>

2. Investments and advances:

	1978	1977
	(Thousands of dollars)	
Loans, mortgages and debentures	\$ 6,536	\$ 7,824
Shares	1,226	424
Listed securities, at cost	—	3,454
	<u>\$ 7,762</u>	<u>\$ 11,702</u>

The sale of the listed securities resulted in a profit of \$2,736,000 which is included in investment and sundry income.

3. Fixed assets:

	Cost	Accumulated depreciation	Net book value
	(Millions of dollars)		
December 31, 1978 —			
Plant, machinery and facilities —			
Pulp and paper	\$406.3	\$226.0	\$180.3
Packaging	175.2	108.4	66.8
Construction materials	147.4	73.3	74.1
Chemicals	127.3	75.5	51.8
Other	2.4	1.3	1.1
Timber limits and land	32.9	4.2	28.7
	<u>\$891.5</u>	<u>\$488.7</u>	<u>\$402.8</u>
December 31, 1977 —			
Plant, machinery and facilities —			
Pulp and paper	\$405.0	\$210.7	\$194.3
Packaging	170.4	101.7	68.7
Construction materials	111.0	67.5	43.5
Chemicals	123.4	72.3	51.1
Other	1.8	.5	1.3
Timber limits and land	31.4	4.5	26.9
	<u>\$843.0</u>	<u>\$457.2</u>	<u>\$385.8</u>

4. Funded debt:**Maturity****1978****1977**

(Thousands of dollars)

Domtar Inc. —

Sinking fund debentures —

5¼ % Series "A"	1978	\$ —	\$ 6,250
6¼ % Series "B"	1980	2,850	3,525
5½ % Series "C"	1982	5,900	7,700
5¾ % Series "D"	1984	9,600	10,244
5⅝ % Series "E"	1990	25,200	26,600
6¾ % Series "F"	1987	29,217	29,217
11 % Series "G"	1995	50,000	50,000
9⅝ % Series "H" (U.S. \$50,000,000)	1996	59,285	49,295

St. Lawrence Corporation Limited —

First mortgage sinking fund bonds — 5% Series "C"

1978

—

3,116

Sinking fund debentures — 6¾ % Series "A"

1980

—

4,800

182,052

190,747

Less: Held for sinking fund

7,046

7,926

175,006

182,821

Less: Due within one year

—

8,882

\$175,006

\$173,939

Instalments due in each of the next five years:

1979

1980

1981

1982

1983

(Thousands of dollars)

Nil

\$2,689

\$7,232

\$14,179

\$10,079

5. Minority interest:

1978

1977

(Thousands of dollars)

Equity in subsidiaries —

Common shares

\$ 3,209

\$ 4,185

Preferred shares

—

7,040

\$ 3,209

\$ 11,225

6. Corporate reorganization:

Pursuant to a reorganization of the corporate structure a Certificate of Amalgamation was issued on October 31, 1978 amalgamating the Corporation with certain of its subsidiaries effective on that date.

7. Stated capital:

In December 1978 the Corporation increased the common share stated capital account by capitalizing \$48,930,000 of retained earnings. For income tax purposes this transaction was regarded as a deemed dividend of \$3.30 per share out of the 1971 capital surplus account.

30

8. Accounting change — translation of foreign currencies:

In prior years the Corporation followed the practice of translating foreign currency transactions and foreign currency financial statements on the current-noncurrent method. In 1978 the Corporation adopted the temporal method of translation as recommended by the Canadian Institute of Chartered Accountants. This change in the method of translation had no significant impact on the 1978 net earnings and would have had no material effect on prior years' net earnings if applied retroactively. This change also resulted in an unamortized balance of unrealized exchange losses of \$8,596,000 at December 31, 1978 as disclosed on the balance sheet under intangible assets and deferred charges.

9. Businesses acquired:

The acquisitions of the Corporation in 1978 included the purchase of the assets of the gypsum business formerly conducted by Kaiser Cement and Gypsum Corporation on the west coast of the United States and in Mexico and the trucking business carried on by Charles Harris & Sons Transport Limited, Burlington, Ontario.

(Thousands of dollars)

Net assets acquired at assigned values:

Fixed assets	\$25,337
Working capital	1,373
Investment in an associated company	593
Intangibles — rights, licenses and leases	5,420
Deferred income taxes	1,862
	<hr/>
	34,585

Excess of cost over assigned values of net assets acquired

208

Net assets acquired for cash

\$34,793

10. Pension plans:

The Corporation and its subsidiaries have pension plans for their employees. The cost charged against earnings in 1978 was \$11,894,000 (1977 — \$8,944,000).

The Corporation's pension plans were changed during the year to provide certain pension improvements for the employees and officers. In addition pension plans have been assumed in respect of businesses acquired. After giving effect to the changes, the liability for benefits in respect of past service remaining to be charged to operations approximated \$53,326,000 at December 31, 1978 (1977 — \$22,428,000). This cost will be amortized and funded over periods of up to 15 years.

11. Remuneration of directors and senior officers:

The aggregate direct remuneration paid or payable in 1978 by the Corporation and its subsidiaries to the directors and senior officers was \$1,774,000 (1977 — \$1,484,000).

12. Classes of business:

The following classes of business have been determined by the directors to be those which most accurately disclose the diversity of the operations of the Corporation and its subsidiaries.

	1978		1977	
		(Millions of dollars)		
	Sales	Operating profit	Sales	Operating profit
Pulp and paper	\$ 564.9	\$ 39.7	\$ 460.4	\$ 6.8
Packaging.....	209.7	21.4	194.6	13.6
Construction materials	281.0	25.5	197.4	10.4
Chemicals.....	194.2	25.6	169.8	20.1
Inter-class eliminations.....	(8.9)	—	(12.7)	—
	<u>\$1,240.9</u>	<u>112.2</u>	<u>\$1,009.5</u>	<u>50.9</u>
Loss on disposal of fixed assets		(2.3)		—
Corporate income		<u>10.6</u>		<u>7.8</u>
Earnings before interest, income taxes and minority interest		<u>\$120.5</u>		<u>\$58.7</u>

13. Commitments and contingent liabilities:

The Corporation and its subsidiaries are contingently liable for \$1,100,000 (1977 — \$1,650,000) as guarantor of obligations of other companies and CMHC mortgages on employee houses.

Of the 1979 capital expenditures program the Corporation is committed for approximately \$10,000,000.

There are outstanding lawsuits and claims against the Corporation as follows:

- (a) Proceedings instituted by certain Cree Indians alleging that the mercury content of the environment has partly been caused by mercury discharges of the Corporation's chemical plant at Lebel-sur-Quévillon, Quebec and that they have exclusive rights to a territory in Northern Quebec including the location of the Lebel-sur-Quévillon pulp mill complex. They are claiming from the Corporation, jointly and severally with several other companies, an amount of approximately \$5,200,000 in damages. In addition they request that the Corporation be evicted from the area.
- (b) Various lawsuits and claims aggregating \$3,300,000.

The Corporation is contesting these lawsuits and claims and does not consider that their outcome will have a material adverse effect on the Corporation and its subsidiaries.

14. Anti-inflation program:

The Corporation and its Canadian subsidiaries were subject to controls on prices, profits, employee compensation and dividends under the federal anti-inflation program enacted on October 14, 1975. The Corporation is of the opinion that it has complied with this legislation.

15. Subsequent event:

The Corporation has acquired from Reed Ltd. a recycle linerboard mill, associated waste collection facilities and three corrugated container plants for a cost, including inventories, of approximately \$27 million. A further \$3 million is expected to be required for additional working capital.

Auditors' Report

To the Shareholders of
Domtar Inc.

We have examined the consolidated balance sheet of Domtar Inc. as at December 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles which, except for the change in the method of accounting for foreign currency translations referred to in Note 8 to the financial statements, have been applied on a basis consistent with that of the preceding year.

PRICE WATERHOUSE & CO.
Chartered Accountants

Montreal, January 30, 1979

Inflation Accounting

The Corporation is continuing the practice established in 1974 of including price-level adjusted financial information in this report.

The application of price-level accounting concepts has the effect of restating the 1978 reported net earnings of \$4.23 per common share to \$2.29 per common share.

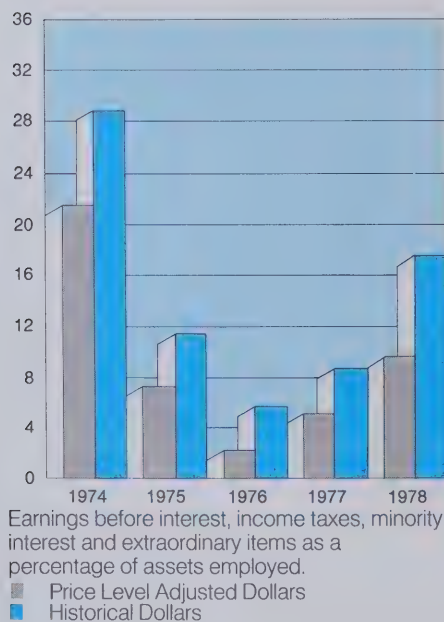
A major impact of the use of price-level accounting, as indicated on the graph, is the reduction in the return (before income taxes and extraordinary items) on assets employed from 17.5% to 9.7% for 1978 and from 8.9% to 4.5% for 1977.

The Corporation is also continuing to provide a supplementary statement to reflect the effects of inflation on funds available for distribution or expansion as recommended in 1977 by the Ontario Government's Committee on Inflation Accounting. The statement is intended to focus attention on the additional sums of money which should be set aside to cover the effects of inflation on the replacement of inventories and the maintenance of plant, machinery and equipment at today's cost.

The corrosive impact of inflation is evident from either the use of price-level accounting concepts proposed by the accounting profession or the statement recommended by the Ontario Committee. It is clear that generally accepted accounting principles do not display this condition and changes are required to report profitability in real terms and indicate to business, government and the general public the nature and magnitude of the effects of inflation on the financial health of the Corporation.

With a better understanding of the impact of inflation on corporate profits, business may improve the process of capital investments; government may develop a better approach to economic and taxation policies; and the general public may give added support to efforts to eliminate inflation.

Percentage Return Before Taxes on Assets Employed 1974-1978
(Percent)



**Comparison of funds available for
distribution or expansion on historic basis
of accounting and replacement basis
for the year ended December 31, 1978**

(in thousands of dollars)

	Historic Basis	Replacement Basis
Cash flow from operations — from statement of changes in financial position — after allowing for all cash costs and taxes payable	\$ 123,045	\$ 123,045
Funds required to replace productive assets — assumed to equal depreciation (*)	43,629	108,204
Funds required to replace inventories (**)	<u>—</u>	<u>9,687</u>
Funds available for investment in productivity or growth or for distribution as dividends <i>before</i> financing adjustment	79,416	5,154
Financing adjustment — additional funds which <i>may</i> be available from borrowings-assuming constant financial ratios (***)	<u>—</u>	<u>11,362</u>
Funds available for investment in productivity or growth or for distribution as dividends <i>after</i> financing adjustment	<u>\$ 79,416</u>	<u>\$ 16,516</u>

NOTES:

- (*) The increased cost of maintaining the operating capacity of productive assets (\$64,575,000) represents the difference between depreciation determined on a historic cost basis and that determined on the replacement cost of the productive assets.
- (**) The increased cost of replacing inventories (\$9,687,000) represents the difference between the historical cost and the current cost of goods sold at the date of sale.
- (***) The extent to which additional funds *may* be available from borrowings (\$11,362,000) is based on the ratio of non-equity capital to non-equity capital plus equity capital at the beginning of the accounting period.

Domtar Inc. and Subsidiaries

Historical Review

(Dollars in millions except per share amounts)

		1978	1977	1976	1975	1974	
STATEMENT OF EARNINGS	SALES	Pulp and paper	564.9	460.4	374.2	350.0	439.4
		Packaging.....	209.7	194.6	197.9	166.0	193.9
		Chemicals.....	194.2	169.8	156.7	149.4	134.3
		Construction materials	281.0	197.4	172.0	160.1	144.1
		Inter-class eliminations.....	(8.9)	(12.7)	(14.0)	(10.3)	(14.0)
			1,240.9	1,009.5	886.8	815.2	897.7
	OTHER REVENUES	Investment and sundry income.....	14.0	9.0	9.6	8.1	9.0
		Gain on disposal of fixed assets...	—	—	1.6	3.8	—
			1,254.9	1,018.5	898.0	827.1	906.7
	COSTS AND EXPENSES	Cost of sales and selling and administrative expenses	1,088.5	920.8	828.7	725.6	720.2
Depreciation		43.6	38.9	35.4	31.7	30.7	
Loss on disposal of fixed assets...		2.3	—	—	—	—	
Interest—Funded debt		15.7	16.0	13.3	8.6	6.7	
— Other indebtedness		1.3	0.9	1.0	0.9	0.6	
Income taxes — Current.....		28.1	12.8	3.7	11.9	55.6	
— Deferred.....		11.4	1.0	4.2	12.0	8.9	
Minority interest		0.7	1.3	1.1	1.1	1.5	
		1,191.6	991.7	887.4	791.8	824.2	
Net earnings		63.3	26.8	10.6	35.3	82.5	
PER COMMON SHARE	Earnings	4.23	1.78	0.68	2.34	5.53	
	Dividends.....	1.10	0.80	1.00	1.60	1.60	
	Cash flow.....	8.26	4.56	3.32	5.11	8.30	
	Shareholders' equity	25.78	22.65	21.67	22.00	21.25	
OTHER STATISTICS	Number of preference shareholders	1,486	1,537	1,613	1,654	1,671	
	Number of common shareholders	20,393	22,244	23,330	25,815	26,920	
	Common shares outstanding.....	14,827,300	14,827,300	14,827,300	14,827,300	14,827,300	
	Number of employees.....	17,414	16,815	17,520	17,637	18,450	
	Employees' salaries, wages and benefits	337.0	297.3	273.9	232.9	230.7	

		1978	1977	1976	1975	1974	
CASH FLOW AND FINANCIAL POSITION CHANGES	FUNDS PROVIDED BY	Net earnings.....	63.3	26.8	10.6	35.3	82.5
		Add back: Fixed asset disposals (gain) loss	2.3	—	(1.6)	(3.8)	—
		Depreciation.....	43.6	38.9	35.4	31.7	30.7
		Deferred income taxes	11.4	1.0	4.2	12.0	8.9
		Minority interest.....	0.7	1.3	1.1	1.1	1.5
		Other	1.7	0.2	0.1	—	—
		Cash flow from operations	123.0	68.2	49.8	76.3	123.6
		Issues of funded debt.....	—	—	48.9	49.0	—
		Investments and advances reduction	4.7	0.2	0.5	4.8	7.5
		Fixed asset disposals proceeds	3.5	4.6	4.4	4.7	1.0
		131.2	73.0	103.6	134.8	132.1	
	FUNDS USED FOR	Fixed asset purchases	41.0	38.0	44.4	57.7	73.4
		Businesses acquired (less working capital).....	33.4	12.7	5.1	—	1.4
		Funded debt reduction	8.9	16.6	8.9	8.0	7.1
		Minority interest reduction	8.7	3.9	1.0	1.1	2.0
		Preference shares purchased	—	0.5	—	—	0.8
		Dividends.....	16.8	12.4	15.4	24.3	24.3
			108.8	84.1	74.8	91.1	109.0
		Increase (decrease) in working capital	22.4	(11.1)	28.8	43.7	23.1
		Increase in non-cash working capital	14.4	2.9	20.9	2.8	30.8
NET	Increase (decrease) in cash and short-term investments less bank indebtedness	8.0	(14.0)	7.9	40.9	(7.7)	
SUMMARY BALANCE SHEET	NET ASSETS	Cash and short-term investments less bank indebtedness	81.0	72.9	86.9	79.0	38.1
		Non-cash working capital.....	178.2	164.0	161.1	140.2	137.4
		Investments and advances.....	7.8	11.7	11.8	14.3	19.1
		Net fixed assets	402.8	385.8	378.7	364.3	339.2
		Intangible assets and deferred charges	15.8	2.1	2.3	1.0	—
			685.6	636.5	640.8	598.8	533.8
	FINANCED BY	Funded debt	175.0	173.9	190.5	150.1	108.1
		Deferred income taxes	113.1	103.5	102.5	97.8	85.8
		Minority interest	3.2	11.2	13.9	12.2	12.2
		Shareholders' equity	394.3	347.9	333.9	338.7	327.7
			685.6	636.5	640.8	598.8	533.8

Directors and Officers

Directors

Alex E. Barron, Toronto,
Chairman of the Board,
Canadian Tire Corporation
Limited

Pierre Côté, C.M., Quebec,
Chairman of the Board;
Laiterie Laval Limitée

H. Roy Crabtree, Montreal,
Chairman and President,
Wabasso Limited

Robert Després, C.M., Quebec,
President and Chief
Executive Officer,
National Cablevision Ltd.

Roger T. Hager,
Vancouver,
Director, The Canadian
Fishing Company Limited

Alex D. Hamilton,
Montreal,
President and Chief
Executive Officer,
Dontar Inc.

J. G. Kirkpatrick, Q.C.,
Montreal,
Senior Partner in the legal
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Montgomery, Renault,
Clarke, Kirkpatrick, Hannon
& Howard

Camille Lacroix,
St. Romuald, Quebec,
President, Matapedia
Company Limited

Roger Létourneau, Q.C.,
LL.D., Quebec,
Senior Partner in the legal
firm of Létourneau, Stein,
Marseille, Delisle & LaRue

Maxwell C. G. Meighen,
O.B.E., Toronto,
Chairman of the Board,
Canadian General
Investments Limited

Arthur Ross, New York,
Vice Chairman and
Managing Director, Central
National Corporation

Lorne C. Webster,
Montreal,
President,
Prenor Group Ltd.

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Chairman

Alex E. Barron,

Pierre Côté

H. Roy Crabtree

Alex D. Hamilton

Arthur Ross

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Alex E. Barron

H. Roy Crabtree

Robert Després

J. G. Kirkpatrick

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Lorne C. Webster

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Pierre Côté

H. Roy Crabtree

Alex D. Hamilton

Arthur Ross

Salary and Compensation Committee

H. Roy Crabtree, Chairman

Alex E. Barron

Alex D. Hamilton

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Chairman of the Board

Alex D. Hamilton,
President and Chief
Executive Officer

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Executive Vice-President

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Vice-President

B. Daigle,
Vice-President —
Engineering, Purchasing
and Transportation

W. D. Davidson,
Vice-President

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Vice-President

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Vice-President

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and Environmental
Technology

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Vice-President —
Administration and
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Vice-President — Labour
Relations

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Vice-President

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D. J. Speirs,
Vice-President — Finance

G. M. Drodge,
Controller

A. Gascon,
Assistant Vice-President,
Assistant Secretary and
General Counsel

F. E. Hertha,
Treasurer

E. G. Aust,
Assistant Treasurer

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President —
W. D. Davidson

Domtar Construction Materials

President — J. Cochran

Domtar Packaging

President — W. R. Lawson

Domtar Pulp & Paper Products

President —
J. H. Robertson
Executive Vice-President —
R. R. Pinard

Domtar Fine Papers

Vice-President and General
Manager — B. R. Grant

Domtar Forest Products

Vice-President —
A. S. Fleming

Domtar Newsprint

Vice-President and General
Manager — G. R. Simpson

Domtar Pulp

Vice-President and General
Manager — T. R. Hall

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N.S.; Saint John, N.B.; Montreal, Que.;
Toronto, Ont.; Winnipeg, Man.; Regina,
Sask.; Calgary, Alta.; Vancouver, B.C.

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The Bank of New York,
New York, N.Y.

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Toronto, Ont.; Winnipeg, Man.; Regina,
Sask.; Calgary, Alta.; Vancouver, B.C.

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The Bank of New York,
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